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ORGANIZATIONAL DEVELOPMENT PROCESS OF SMALL TO MEDIUM SIZE ENTERPRISES

by Fabio Antoldi

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ORGANIZATIONAL DEVELOPMENT PROCESS OF SMALL TO MEDIUM SIZE ENTERPRISES

by Fabio Antoldi

1. Introduction

Is it better to have a manager or an entrepreneur to run a small enterprise? In other words, is it better for the organisation and company strategy of a small or medium enterprise (SME) to be the exclusive province of its owners, or for part of the management responsibility to be delegated to professional managers with effective decision-making power within the firm?

To tell the truth, this question is ill expressed, for at least two reasons. The first is that it is not true that managers and entrepreneurs are alternative figures in competition.

On the contrary, their roles are different but absolutely complementary in an efficient organisational system. Secondly, these two organisational solutions for the enterprise (a strictly entrepreneurial arrangement or a more managerial one) are rarely in competition with each other. More often, they represent successive stages in the evolution of a firm.

Nevertheless the initial question, albeit posed in provocative terms, offers food for thought about the fundamental characteristics of a firm whose structure and main strength depend on the figure of the entrepreneur-owner, and about how this organisational condition (an entrepreneurial arrangement) may in some cases evolve successfully into solutions involving the effective use of specialised professional managers (managerial arrangement). The purpose of the latter arrangement is to assist and supplement the skills and organisational function of the entrepreneur.

2. The recurrent features: entrepreneurship, simple organisational arrangements, particular strategies and family ownership.

This is a type of company whose organisational arrangements, strategic logic, decision-making processes, and development paths are absolutely particular, sometimes substantially different from the management models adopted by larger companies.

A small firm, in fact, is not just a miniature version of a big company. It is instead a company with particular characteristics to which the managerial principles designed for large companies cannot always be applied (even on a reduced scale).

Before considering the particular features of SMEs in detail, we first need to define what we mean when we speak of small and medium enterprises. That is not as easy as it might seem, bearing in mind that there are innumerable ways of classifying enterprises and that the various classifications - especially those based on quantitative dimensions - do not adequately take into account the different structural profiles of the various sectors.

Thus while it might seem easiest to divide enterprises into micro, small, medium and large following size parameters (such as the number of employees, the turnover or the assets), in order

to understand the most suitable management solutions to ensure sound management and possibly an appropriate growth strategy for the SME, it is better to refer to assessments of a qualitative nature.

From this standpoint we can highlight four characteristics, typical and nearly always recurrent among small enterprises, that give a clearer picture of the particular strategies and organisation of the SME.

The first of these particular characteristics is *entrepreneurship*, or the fact that the activity of analysis and decision-making in company governance is often carried out by one person (the sole entrepreneur), or by a very small strategic board, essentially composed of the owners, possibly enlarged to include family members of trusted people.

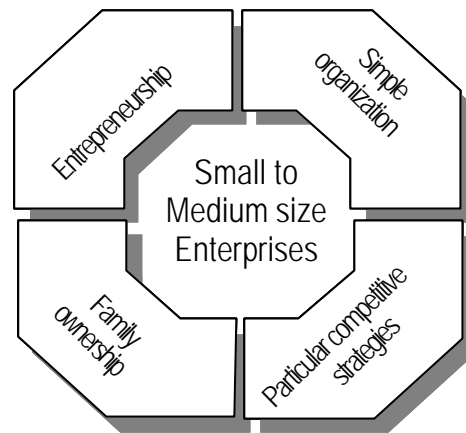
A second element characteristic of SMEs is that they nearly always have *an organisational arrangement that tends to be simple, flat, with few levels and usually not very formal*, in which the division of work is decided by the company leader and carried out in a dynamic mode, rather than a predetermined one, as in firms with organisation charts or job descriptions. In these small firms, even specialisation at work - albeit necessary in company organisation - is a dynamic concept, in that people are often asked to take on several roles in the organisation and to have multiple skills, to be used as required. These characteristics enable SMEs to be highly flexible organisations, able to change rapidly and more easily than large enterprises.

The third characteristic concerns the set of strategic options that can be and are followed successfully by SMEs. Here we refer in particular to the competitive contexts in which it is worthwhile for SMEs to operate and the most suitable competitive strategies for their structure. *The range of successful competitive strategies of SMEs does not in fact coincide with that of large companies*, because by nature they cannot always compete with the larger companies. In particular, SMEs generally operate in more restricted competitive environments compared with large companies, being more limited in terms of the range of customers served, the sector and the geographical size of the market. They tend in particular to adopt focussing strategies successfully, combining their activities in order to create an ad-hoc chain of value for specific segments of customers.

Lastly – and this is the fourth characteristic - in the great majority of cases SMEs have *an ownership arrangement of the family type*, in which ownership and governance are totally concentrated in the hands of the members of one or more families.

In this essay we shall specifically examine the first two characteristics listed above, describing how the relationship between entrepreneurship and the organisational arrangement can change during the development cycle of the SME.

Figure 1: The four recurrent characteristics in the arrangements of SMEs.



3. Entrepreneurship, or rather the entrepreneur as the "driving force" of the enterprise

When one examines the development paths and company histories of SMEs one can easily see that there are hardly ever any formal documents setting out the company strategy, because that strategy essentially stems from the company leader's intuitive vision. In other words it is the final fruit of a long series of decisions - generally showing consistency, if the firm is successful - that are rooted in the entrepreneur's knowledge of the market and the experience he/she has gained. Such knowledge and experience is usually acquired in the context of production (less often in that of sales) and is subsequently sharpened through close links with customers.

At the outset an entrepreneur's vision of his business is usually highly intuitive, but as time passes it becomes more precise, through a process of on-the-job learning and trial-and-error. This vision guides the organisation, becoming ever clearer in the entrepreneur's mind as his enterprise advances. And yet it remains in this implicit form for a long term, without finding real expression other than the reflections and "feel" (often instinctive and based on mood) of its creator.

The entrepreneur himself is thus the "physiological" kingpin around which the entire strategic and organisational configuration of the SME revolves. While this is especially true in the early stages of the firm's history, it also tends to continue as the enterprise evolves, passing from generation to generation, albeit with different intensity.

The entrepreneur is thus the fulcrum of his firm's diligence, the engine of its innovation, and, on the organisational and strategic level, the unchallenged (and sometimes charismatic) leader of the organisational system. Entrepreneurial leadership is characterised by an analytical and decision-making ability that is often informal, intuitive, quick, and strongly fostered by the entrepreneur's absolute dedication to his work. A further important element is often a deep knowledge of his sector, stemming from experience in the field and strengthened by fact that the firm's activities focus on one or few businesses over which he can exercise direct personal control.

The elements on which the strategy of an SME is based can be represented well in brief by using the "*business idea*" concept put forward by Richard Normann (1977). According to Normann, a firm's chances of developing sufficient competitive edge to ensure dominance of its

own market depend essentially on the entrepreneur's ability to combine three elements in a beneficial way: (a) an astute choice of the *segment of customers he plans to target*, focusing accurately on their needs; (b) the development of a *productive system adequate for these customers*, in that it meets their needs; and (c) lastly, the construction of an *enterprise model*, through a configuration of the firm's internal conditions, its organizational and production processes, to make this product efficiently.

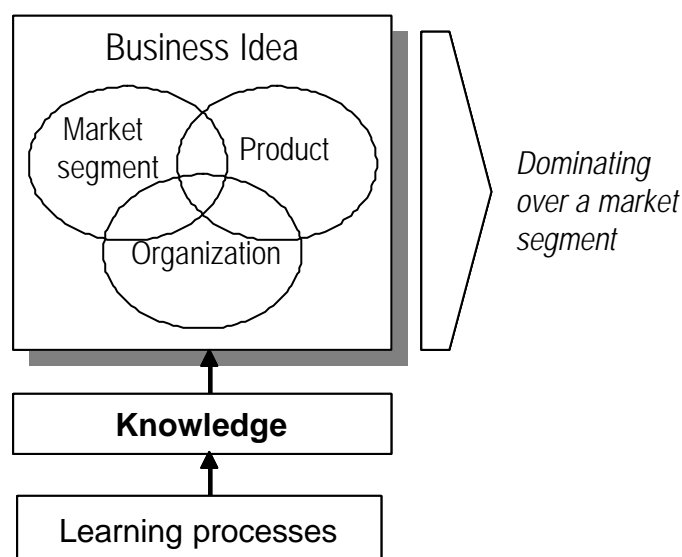
Creating an enterprise essentially involves having these three elements clearly in mind and in general all successful entrepreneurs - even if they have never put their strategy down in black and white - know precisely which *customers* they have in mind, which *products* they want to make and *how* to produce them. At the very least, these are the three great questions that an entrepreneur thinks about constantly, until his own, personal, unique entrepreneurial formula emerges.

As a rule he or she has only a hazy idea of these three elements at first, an intuition that remains implicit in his mind for a long time, until it becomes a sort of "dream" that sets his course. Later, as the company progresses, the entrepreneurial formula - a sort of "company recipe" - acquires definition and consolidation, becoming the basic concept that guides the entrepreneur in his choices, and is eventually expressed and shared with his collaborators.

But what underlies the entrepreneur's ability to combine these three elements in a beneficial way that provides the basis of his success? Essentially that ability is based on *knowledge*, on his "know how" regarding markets, technologies, products and selling processes concerning his business. Such knowledge is usually not codified, for it stems mainly from direct experience.

It is not static knowledge but is somewhat dynamic, continuously enriched by *learning mechanisms*, which enable him to remodel and change the entrepreneurial formula continuously to adapt it to changes in customers, technologies, tastes, legal regulations or the market.

Figure 2: Business idea, knowledge and learning (adapted from Normann, 1977)



An SME achieves lasting success – success that is continuous, not fleeting - to the extent that the entrepreneur never interrupts these learning circuits that fuel his knowledge. For this reason the entrepreneur of a successful SME must be curious, lively, innovative, perhaps even permanently dissatisfied; his restlessness constantly prompts him to innovate. He should never rest on his laurels, settle for what he has already achieved or - worse still - adopt passive or nostalgic attitudes towards changes that are under way and uncertain future scenarios.

Especially in periods of high tension and sectorial changes, like those we are now experiencing, an entrepreneur who does not continuously update his knowledge and fails to reconfigure his entrepreneurial formula runs a serious risk of causing a crisis in his enterprise.

4. Strong and weak points of the entrepreneurial model

Compared with other company organisation models, that of the entrepreneurial type (centred on the entrepreneur) obviously has some strong and weak points.

Among its strong points we should first emphasize extreme practicality in the company practices, due to the entrepreneur's direct involvement in the operational work. This ensures that he has direct, immediate knowledge of the company's problems and opportunities, is rapid and pragmatic in finding proper solutions to daily problems, and does not waste much time on theories, abstractions or useless, inefficient bureaucracy.

Another merit of the model is that it helps the enterprise to adapt quickly to what is happening around it, a condition that makes an SME a flexible organisation, better able than large companies to intercept specific demand for non-standardized products, to identify and quickly occupy unexplored and potentially profitable niches. This is partly because of its short, fast chain of command, and partly because, not having defined organisational roles, it can quickly change its organisational arrangements.

Moreover, SMEs can exploit the fact that their distinctive skills and strategic management resources are nearly always unique and cannot easily be imitated by other companies, because they lie with the entrepreneur (and are therefore by definition not replicable) or with other people who work for the SME (whose staff turn-over is generally low).

We should highlight one last important characteristic of this model, namely the organisation's absolute dedication to pre-chosen goals, its company *commitment*, which stems on one hand from the total coincidence of its company objectives with those of its leader, and on the other, the commitment given by all collaborators, which is often the maximum too, because of their direct communication with the entrepreneur and his strong control, as well as the cultural homogeneity and similarity between him and them that usually exists.

Among the weak points, however, we should mention that many entrepreneurs focus excessively on operational management, which may become a risk factor for the enterprise. Precisely because they are personally involved in production, technical or sales activities, small entrepreneurs sometimes risk being crushed by daily management, eclipsing their opportunities

and their duty to free their minds and diaries to spend more time on strategic decisions regarding the firm's future.

Even focusing on one or few markets - which can be a winning choice in constructing a sustainable competitive strategy - risks being counterproductive if it unduly limits the knowledge of the firm and its entrepreneur regarding other potentially interesting sectors. There is a risk of developing a kind of entrepreneurial myopia that prevents one from spotting new business opportunities in good time.

A third weak point is that SMEs tend to overlook the need for planning and analysis, which may result in an inadequate ability to foresee the scenarios and economic-financial effects of future actions at the time when key decisions are taken. This tendency is illustrated, for example, by the still very low use by SMEs of instruments such as budgets or business plans, and by their tendency to examine economic data only when they have the final figures - too late to be able to use them for current planning.

Lastly, the entrepreneurial model, especially among SMEs, often suffers from the lack of a proper managerial culture. In other words, they have little ability to view the enterprise with systemic, global vision that, making proper use of management techniques and instruments, enables a company decision-maker to control the development of the entrepreneurial formula efficiently. This is usually due to the particular background of many small entrepreneurs, especially first-generation ones, who typically base their enterprise on great experience and strong motivation, but really have little specific knowledge in the field of company management. We should recall that, regardless of the initial educational background of the company leader, the competitive success of SMEs flows from incessant increments of knowledge: systemic, continuous acquisition of knowledge of the company and sectorial working mechanisms is the key factor affecting an SME's chances of evolving.

5. The transition to more sophisticated organisational arrangements.

A second characteristic that, as we have seen, distinguishes SMEs is that their organisational arrangements tend to be simple. Here we see the combined effect, in organisational terms, of the nature of entrepreneurship and of the small size of this type of enterprise.

To tell the truth, organisational simplicity and essentiality are valued primarily in the smallest firms, while medium-sized companies often tend to evolve gradually towards arrangements closer to those of large ones. However, one should be careful to adapt or even change such arrangements to take account of the presence of the entrepreneur, who remains central in the structure and in the operational mechanisms.

However, the extreme and essential simplicity of the organisational forms of some SMEs should not lead one to think that this shows disorganisation. Just the opposite. Indeed, low organisational investment is often by far the most efficient and therefore best way, from the standpoint of company economics, to organise the work of such firms.

In analysing the organisational matters of SMEs, on a purely introductory basis, we will find it helpful to adopt a logical framework with two key variables. These are the nature and competitive context that the SME faces, on one hand, and the level of its internal complexity on the other. The

latter variable is in practice correlated with the firm's progressive development regarding product ranges or business areas, the articulation and specialisation of operational units, foreign markets, and the number and diversity of its personnel (Preti, 1991).

The smallest enterprises typically have an elementary arrangement. The structure of their organisational model is flat, with only one hierarchical level, obviously consisting of the entrepreneur, to whom all collaborators report directly. He exercises direct supervision of his employees and intervenes systemically in the work they carry out.

As a minimum the entrepreneur is involved, but more often he is the ultimate decision-maker, in production as much as in commercial relationships, in purchasing as much as in selection and assessment (usually subjective) of his collaborators. Because of his collaborators' obvious daily proximity, he often has strong emotional and social links (positive or negative) with them. Such links go beyond a simple professional relationship.

As a consequence of the absolute centrality of the entrepreneur, work is mainly allocated to collaborators on an informal basis, and may also be variable in quantity, so that in some cases there are no rigid, definitive, unambiguous roles based on explicit, defined orders of division and specialisation of work.

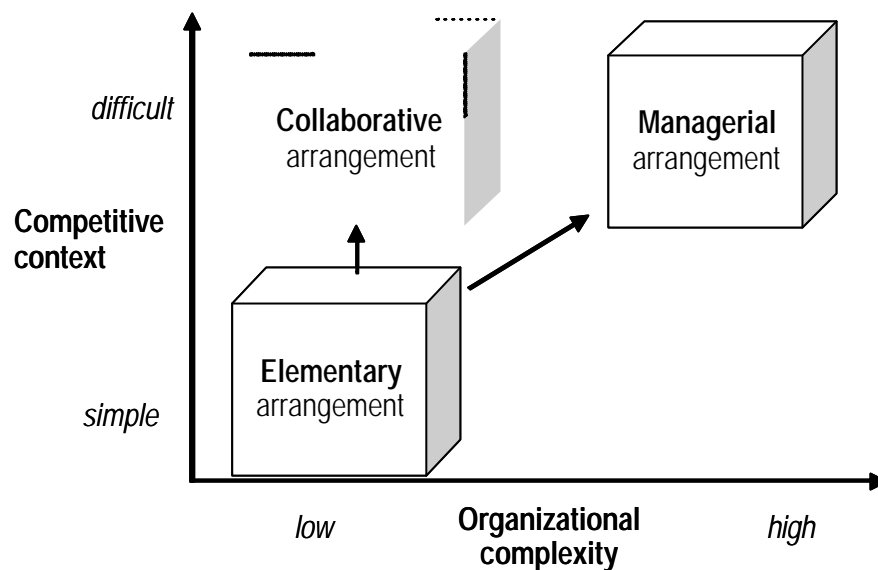
This fact helps to maintain a good level of flexibility in the structure, as in this way people can change tasks according to the needs and orders given by the entrepreneur.

While this might in some cases seem an unduly simple concept of work organisation, in the smallest firms it adequately meets the organisational needs of elementary economic and productive processes, and moreover offers several advantages:

- it perfectly responds to the decision-making style of the entrepreneurial type (the entrepreneur is the central figure);
- it is a highly flexible arrangement, easily adaptable to changes needed in production processes or required by customers or unforeseen circumstances (because it allows people to change roles);
- it is alert to signs of change coming from the outside, because the entrepreneur, sole manager of the internal structure, acts as the catalyst of all external relationships and is thus in an ideal position to react with changes of company strategy. In a firm of this type that strategy typically remains intuitive and implicit, in the entrepreneur's mind, as there is no real need to make it explicit.

Lastly, and this is no small matter, the elementary model is inexpensive, an organisational model that keeps structural costs down. Having no intermediate manager between the strategic leader and the operational resources means lower personnel costs, lower control costs and greater flexibility in the use of staff. For firms that often operate in conditions of scarce resources, this is far from being unimportant.

Figure 3: The possible evolutionary paths of the SME (adapted from Preti, 1991)



The elementary arrangement is however adequate only in particular conditions. In fact it only works well for enterprises with low organisational complexity, where the personnel are not too numerous and can be managed easily - for example where collaborators show similarity within each professional profile - and where at the same time the number of areas of responsibility and of results is limited. In other words, the organisational complexity is such that the entrepreneur can control it directly.

It also works well if the external competitive context is not very difficult, and stable, with low uncertainty. The entrepreneur can thus easily predict and control the situation using his own direct knowledge, without needing recourse to higher skills, which would require the presence of more specialised personnel within the company structure.

However, the internal and external conditions may suddenly worsen, forcing the enterprise to change its arrangements. This may be because it has already begun a process of enlargement, of diversification, of extension into different geographical markets that increases its internal complexity. Alternatively, it may be because in time the competitive situation shows signs of worsening: greater competitive pressure, more turbulence, the beginning of processes of concentration or internationalisation in the sector that make it difficult to continue for long with an elementary arrangement. In short, when the organisational complexity increases, or when the external competitive situation worsens, the elementary organisational arrangement is no longer suitable and the enterprise should be steered towards more sophisticated ones.

The most appropriate alternative to face a situation of simultaneous worsening of the competitive situation and an increase in internal complexity is to switch to an arrangement of the managerial type, in which the entrepreneur is supported by managers with special functions, business managers, and/or professionals with specialised skills. This is often a necessary step that the entrepreneur does not always undertake gladly and in good time, because such a move

inevitably throws his role as sole decision-maker into question, implies a redefinition of the company leadership and, lastly - if the enterprise is of the family type - also affects the possible career paths of members of the entrepreneurial family.

The adoption of a managerial arrangement involves the entrepreneur in a progressive process of delegation. This means allocating definite areas of responsibility to his managers, in which they can exercise certain decision-making powers, determined by the goals and conditions defined by the company leader.

When this new arrangement is adopted there is a gradual – and often slow and far from linear - separation between the *entrepreneurial function* in the strict sense, which should take on a higher strategic content, and the *managerial or executive function*, which involves the exercise of delegated decision-making powers in the context of precise areas of competence.

This transition involves a greater need for coordination between people, the formalisation of certain personnel management principles, the progressive introduction of systems of performance measurement, of planning, and then the definition and allocation of objectives that - together with decision-making powers - provide for the effective exercise of the delegated responsibilities. The presence of professional skills of a higher type than those needed in the elementary arrangement also raises problems of staff careers, an issue that has a particular impact on family enterprises, where family members usually occupy the positions of greater responsibility.

When should one start considering the adoption of a managerial-type arrangement, in a small enterprise? Several concurrent causes may prompt the need to abandon the most elementary forms of organisation and transfer progressively to organisational arrangements in which managers support the entrepreneur.

The need for a less "entrepreneur-centric" structure primarily arises during enlargement of the enterprise, when it has embarked on a path of growth that will expand it from a micro enterprise to a small one, or from small to medium. Alternatively it may happen when development in several business areas, regardless of their size, is pushing the firm towards more complex organisational forms, because these areas are hard to manage through the direct control and skills of the sole entrepreneur. However, we should remember that there are no size thresholds or conditions that can objectively signal these evolutionary stages.

The need for a transition to an arrangement of a more managerial type may however emerge suddenly, because of matters unrelated to growth. For example, bringing managerial figures into the company may be an effective (or unavoidable) way of tackling situations of company discontinuity, such as a problematic succession from one generation to the next. In other cases it becomes necessary in order for an SME to be able to take over and subsequently manage or integrate another enterprise. Again, it may occur where alliances, collaborations or consortiums are constituted with other enterprises, or when undertaking strategies of diversification or internationalisation, for which the professional resources, the personal abilities and the strategic competence of the entrepreneur are insufficient to meet more complex competitive challenges with success.

6. The delegation process

The adoption of a managerial arrangement requires the entrepreneur to activate a process of effective delegation and to carry it through successfully.

This implies that the following conditions occur in the SME at the same time: (a) that the delegating entrepreneur has decided to give up part of his prerogative; (b) that the delegated manager is fully able to take on his new responsibility; (c) that what is delegated is effectively decision-making power (delegation is not merely a matter of transferring "activities to be carried out" to others!); (d) that the general organisational situation effectively allows the managers to exercise the power that has been delegated to them and to do so in keeping with the overall company strategy.

The first condition obviously implies that the entrepreneur recognises, above all, that the time has truly come in his life and that of the enterprise when the creation of an executive group is the objective priority, and, secondly, that this means redefining his role in the company. This is an attitude that not all small entrepreneurs are able to adopt, because there are various kinds of entrepreneurs whose professional and human experience takes different forms. For example, those who have great entrepreneurial ability of the visionary type are not always equally able to manage the company during organisational changes such as these.

The second condition is that those who are candidates to accept responsibility delegated by the entrepreneur should have not just the right skills to carry out the tasks linked with them, but also sufficient character and reporting ability to be able to interact closely with the company leader. Selecting the right managers is of fundamental importance, as the relationship between them and the leader has to be beneficial.

The third condition relates to the risk that the delegation of responsibility is not correctly understood and implemented, especially by the delegator. A manager cannot be regarded as a mere executor of orders, nor as a clone of the entrepreneur. Delegating decision-making power means accepting that the manager may tackle and solve problems in ways that differ from those that the entrepreneur would have chosen. What is important is that the results are in line with the goals and are achieved efficiently and in keeping with the company values and strategy. And this shows the importance of making the company strategy explicit.

Finally, the fourth condition is that everything a manager effectively needs in order to be able to make decisions should be put in place: make the goals explicit, define them clearly, provide decision-makers with all the information they want, both general and specialised, allocate resources consistent with the goals, foster a situation and an organisational climate that assists managers in exercising their delegated responsibility, and, at the same time, implement appropriate systems of executive control, as real delegation cannot work without control.

We should recall that the manager-entrepreneur relationship is affected by the fact that managers usually adopt different decision-making styles, because of their different position in the company, their different level of involvement, the different nature of their personal interests and - in general - a different background of culture, experience and training. Empirical research has established that while an entrepreneur usually takes decisions in a manner that is intuitive, opportunistic and quick (because he does not like waiting), preferring informal relationships and

proceeding in steps, showing a preference for flexible structures and solutions (because they create fewer restrictions), a manager is just the opposite. He tries to decide and act in a highly rational manner, prefers to assess the situation analytically first, is methodical, tends to defend the existing situation rather than innovate, is more evolutionary than revolutionary, and tends to be formal in his methods of communication and in arranging his work.

When making the transition to an arrangement of a more managerial type, an SME can implement measures to provide proper support during the delicate stage of decentralising decision-making power from the entrepreneur to the managers. The functional responsibilities involved in the transition need to be precisely defined and described, and it may also be useful for the related decision-making processes to be clearly expressed and structured. It is moreover fundamental to make use of board meetings with the entrepreneur to put in place a group of executives who are able to interact within it (taking care, however, not to abuse this instrument). Lastly, it may be useful to arrange some form of training, or even coaching of the executive group.

7. An alternative way forward: co-operation with other SMEs

As we conclude this analysis of a possible evolutionary route towards more sophisticated organisational arrangements, we should however note that small enterprises and entrepreneurs do not always have the resources and opportunities to aim for the much more demanding arrangements of the managerial type.

Sometimes it is also not worthwhile or necessary, and, when faced with competitive situations that suddenly become less favourable, they may legitimately seek alternatives to enlargement.

There are indeed situations in which an SME may try to arrange an alternative by uniting its efforts with those of other small enterprises. In this way they can together try to create forms of collaboration that allow them to keep their own company structure - small, simple and independent - while asking a higher-level collective organisation (possibly of a temporary nature) to develop those organisational arrangements that can help the small enterprise to maintain its competitiveness.

Here we refer to possible collaborative initiatives between SMEs that may take various forms, ranging from the most challenging, such as *consortiums*, *joint ventures*, *temporary enterprise associations*, with specific aims and of a temporary nature, to simple *formal or informal agreements* between enterprises, such as subcontracting. Depending on the competitive needs of the enterprises, the purpose of this kind of collaboration may be individual, limited production activities or purchasing or sales or distribution activities, programmes of research and innovation or projects to enter foreign markets together.

In general, co-operation with other SMEs can in fact offer small entrepreneurs some interesting advantages, without changing their status and size:

- working together, they can make the investments needed to boost their competitiveness, which otherwise they would not be able to afford alone;
- they can gain access to the skills and resources of the other partners;

- working together, they can develop new strategies regarding brands, innovation, research, penetration of new markets, diversification and sharing of risks, charges and results;
- by uniting their company activities, they can achieve the critical mass required for a market that is perhaps undergoing a process of concentration that favours larger enterprises.

However, we should recognise that cooperation between small entrepreneurs is not at all easy. A collaborative arrangement often proves to be bristling with snares and difficulties for a small enterprise, because it implies a series of difficult choices. The entrepreneur is obliged to revise his role as sole decision-maker, taking account of the partners with whom he collaborates (and it is not always easy to accept that decisions that he had previously taken independently must now be shared with other entrepreneurs). Moreover he still has to make his own strategy explicit, in order to be better able to bring it into line with that of other partners and compare it with the collective strategy. Finally, to make the partnership work properly it is first necessary to define clear rules, shared by the partners, and to implement proper mechanisms of collective governance that give protection against all possible opportunistic behaviour while at the same time permitting efficient management of the collaboration.

Nevertheless, despite all these difficulties, the collaborative arrangement can in some cases provide an interesting option for the organisational development of the SME and can offer a viable alternative to defend competitiveness while retaining the independence and nature of the small enterprise.

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COLLANA WORKING PAPER

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2. Daniele Cerrato, Maria Cristina Piva, *Management familiare, capitale umano e internazionalizzazione delle piccole e medie imprese*, Collana Working Paper del Centro di Ricerca per lo Sviluppo Imprenditoriale dell'Università Cattolica, n. 2/2007
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